

The application of the Retailers' Occupation Tax to sales of computer software is set forth at 86 Ill. Adm. Code 130.1935. (This is a GIL).

November 8, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter dated July 14, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY is a software licensing company located in CITY, Illinois, and doing business throughout the state. We ship all of our products from CITY. Would you please forward any documentation on the state's sales and use tax laws and procedures to the address listed above.

Thank you for your assistance.

The Retailers' Occupation Tax Act, 35 ILCS 120/1 et seq., imposes a tax upon persons engaged in the business of selling tangible personal property at retail. Sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. Canned software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. If the computer software consists of custom computer programs, then the sales of such software are not taxable retail sales. See subsection (c) of Section 130.1935.

Pursuant to 86 Ill. Adm. Code 130.1935, "Computer Software," enclosed, a license of software is not a taxable retail sale if:

- A) it is evidenced by a written agreement signed by the licensor and the customer;
- B) it restricts the customer's duplication and use of the software;
- C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);
- D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) the customer must destroy or return all copies of the software to the vendor at the end of the license period.

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax.

As stated above, a license of computer software is not taxable if it meets all of the criteria listed in Section 130.1935(a)(1)(A-E). However, subparagraph (D) requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed a software license agreement to have met this criterion if the agreement does not contain such a provision, but the vendor's records reflect that it has a policy of providing copies of software at minimal or no cost if the customer loses or damages the software.

Subparagraph (E) also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. The Department has also deemed perpetual license agreements to qualify for this criterion even though no provision is included in the agreement that requires the return or the destruction of the software.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. See the enclosed copy of 86 Ill. Adm. Code 130.1935. The taxability of maintenance agreements depends upon if the charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance agreements are sold separately from tangible personal property, sales of the agreements are not taxable transactions. However, when maintenance services or parts are provided under the maintenance agreements, the services or parts are provided under the maintenance agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act, 35 ILCS 115/1 et seq., that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax (see 35 ILCS 105/1 et seq.) based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Charges for updates of canned software are fully taxable under Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreements would be taxable as sales of canned software.

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Generally, annual renewal fees are not subject to Retailers' Occupation Tax. If, however, the fees were actually gross receipts for the sale of software, they would be subject to tax, even if separately stated on the invoice.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk
Enc.